
TAX ALERT – May 26, 2020

CARES Act Paycheck Protection Program Update

Background

In an effort to encourage businesses to retain employees during the COVID-19 pandemic, the CARES Act permits the Small Business Administration (“SBA”) to guarantee new loans under the Paycheck Protection Program (the “Paycheck Protection Program” or “PPP”) up to a maximum of \$10 million to eligible businesses. These loans are to be used by small businesses to provide for payroll and operational costs and may be partially or even wholly forgiven.

In addition to “small business concerns” as currently defined by the SBA, any business concern, nonprofit, veterans organization, or Tribal business concern may be eligible for a loan if it employs not more than the greater of: a) 500 employees (including full-time, part-time, and those employed on other bases); or b) the size standard for the number of employees established by the SBA for the industry in which the entity operates. In addition, sole proprietorships, independent contractors, and eligible self-employed individuals may also be eligible to receive loans under this program.

Expanded eligibility rules apply for businesses in the accommodation and food service industries, businesses operating as a franchise, or business receiving certain financial assistance under the Small Business Investment Act of 1958. Additionally, for the accommodation and food service industries, businesses with multiple locations may qualify for a loan under the Paycheck Protection Program provided that each location employs 500 or fewer individuals.

Subsequent to passage of the CARES Act, the SBA has released multiple Interim Final Rules (“IFRs”) and maintains a document answering frequently asked questions with respect to the Paycheck Protection Program (“SBA-Treasury FAQ”). In an effort to clarify the rules outlined in the CARES Act, IFR1, issued April 2, 2020, states that a prospective borrower is eligible for a Paycheck Protection Program loan if (i) the borrower has 500 or fewer employees *whose principal place of residence is in the U.S.*, or the business operates in a certain industry and meets the applicable SBA employee-based size standards for that industry; and (ii) the prospective borrower is either a small business concern as defined in the Small Business Act and subject to the SBA’s affiliation rules, or a tax-exempt nonprofit organization, a tax-exempt veterans organization, a Tribal business concern, or *any other business*; and was in operation, with paid employees or independent contractors, on February 15, 2020.

Similarly, IFR2, issued April 3, 2020, states that an entity generally is eligible for the Paycheck Protection Program if it, combined with its affiliates, is a small business as defined in the Small Business Act, or (i) has 500 or fewer employees *whose principal place of residence is in the U.S.* or is a business that operates in a certain industry and meets applicable SBA employee-based size standards for that

industry; and (ii) is a tax-exempt nonprofit organization, a tax-exempt veterans organization, a Tribal business concern, *or any other business concern*.

Despite the IFRs, there remained some uncertainty as to whether U.S. businesses were required to apply the affiliation rules to include foreign employees of foreign affiliates as well as employees whose principal place of residence is in the U.S.

FAQ 44 and The May 21 IFR

On May 5, the SBA-Treasury FAQ was updated with Question 44 (“FAQ 44”), and on May 21, the SBA released an IFR addressing employee-based eligibility requirements for U.S. businesses with foreign affiliates (the “May 21 IFR”).¹

FAQ 44 reads as follows:

Question: How do SBA’s affiliation rules at 13 C.F.R. 121.301(f) apply with regard to counting the employees of foreign and U.S. affiliates?

Answer: For purposes of the PPP’s 500 or fewer employee size standard, an applicant must count all of its employees and the employees of its U.S and foreign affiliates, absent a waiver of or an exception to the affiliation rules. 13 C.F.R. 121.301(f)(6). Business concerns seeking to qualify as a “small business concern” under section 3 of the Small Business Act (15 U.S.C. 632) on the basis of the employee-based size standard must do the same.

FAQ 44, in conjunction with both the CARES Act and the prior IFRs, arguably could be interpreted one of two ways: (i) that the employee size standard includes both U.S. resident employees and non-U.S. resident employees of both the U.S. business and its foreign affiliates; or (ii) that the employee size standard includes only U.S. resident employees of both the U.S. business and its foreign affiliates, but excludes non-U.S. resident employees.

The May 21 IFR, however, clarifies that a U.S. business applying for a loan under the PPP must include all of its employees, both U.S. and non-U.S. resident, including the U.S. business’ foreign and domestic affiliates for purposes of determining whether the U.S. business meets the SBA’s size-based eligibility requirements. It is important to reiterate that this is the normal affiliation rules are still suspended for the accommodation and restaurant industries.

While the SBA acknowledged that prior IFRs may have led to some confusion, this uncertainty, according to the May 21 IFR, was resolved with the publication of FAQ 44 (i.e., the SBA’s position is that only the first interpretation discussed above is correct). Therefore, prospective borrowers have been on notice since May 5, 2020 that they may have been ineligible to apply of a PPP loan if their total employee headcount, including the employees of their foreign and domestic employees, was in excess of the applicable SBA size standard (i.e., the greater of 500 employees or the industry size standard).

¹ The IFR addressing this issue was originally released May 18, 2020 and revised May 21, 2020.

Fortunately, the SBA has chosen to exercise its enforcement discretion due to reasonable borrower confusion and has stated that it will not find any borrower that applied for a PPP loan prior to May 5, 2020 (the date FAQ 44 was published) to be ineligible based on the borrower's exclusion of non-U.S. employees from the borrower's calculation of its employee headcount if the borrower (together with its affiliates) had no more than 500 employees whose principal place of residence is in the United States.

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If you have any questions or would like additional information on the topics covered in this alert, please contact your engagement partner.

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